BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion to Evaluate Existing Practices and Policies for Processing General Rate Cases and to Revise the General Rate Case Plan for Class A Water Companies.	R.03-09-005

COMMENTS OF THE OFFICE OF RATEPAYER ADVOCATES ON THE DRAFT DECISION AND WATER DIVISION WORKSHOP REPORT

Pursuant to the schedule set for in the Administrative Law Judge's ("ALJ's") March 16, 2004 ruling, ORA files its comments on the Draft Decision ("DD") and March 22, 2004 Workshop report issued in the above captioned proceeding.

In the workshops, the parties looked at a number of different ways of forecasting sales, expenses and regulated plant. ORA and the other parties reached agreements on a number of items related to forecasting number of customers, consumption and expenses in the test and escalation years. A contentious issue was how to define and escalate both routine and major capital additions. Workshop parties were unable to reach agreement in the time available.

ORA supports many portions of the DD and many of the workshop recommendations. Specifically ORA supports the consensus workshop recommendations on forecasting of customers, consumption and sales and most of the workshop recommendations on escalating expenses. On issues where parties failed to reach consensus, ORA generally supports the approach taken in the DD and proposes some changes. These issues include determination of the test year, computation of administrative, operation and maintenance expenses, the approach to general office, the handling routine and major capital additions in the test and escalation years, and affiliate and unregulated transactions. ORA's comments will focus on those portions of the workshop report where the parties did not reach a consensus. ORA supports the recommendation to defer certain issues until Phase II in this proceeding, and ORA's comments identify the issues that should be deferred.

Finally, ORA presents for the Commission's consideration a second feasible, and much simpler alternative, to approaching escalation year revenue requirement. ORA is concerned that aspects of this new water rate case plan are becoming increasingly complicated, defeating the streamlining goal of this proceeding. As it is, even the consensus workshop proposals contain provisions for various exceptions. As more and more exceptions are incorporated into the new water rate case plan, they chisel away at the simplicity of the plan and increase staff work load. As a result, ORA recommends considering another approach that would provide the utilities with sufficient capital, protect ratepayers, and be simple to implement.

After the workshops were over, ORA developed a proposal that was not considered in the workshops. This proposal appears feasible and would radically simplify the rate case process. As discussed in Section VI below, this second proposal simply inflates the base margin revenue requirement rather than an item-by-item escalation of expenses and plant additions, and makes adjustments for any increased revenues. ORA offers this second alternative in addition to our other comments so that the Commission may consider a simpler proposal than what has been discussed to date.

I. TEST YEAR

ORA appreciates the dilemma faced by the ALJ and the workshop participants in trying to define a "test year" that is both practical and meets the requirements of Section 455.2(a) and (b) which requires that the Commission issue its final decision on a Class A Water Company so that the decision becomes effective on the first day of the first test year.[1]

As noted in the draft decision, standard ratemaking practice uses "test year" to refer to the "12-month period over which projected costs and revenues are evaluated to determine if a rate change is required." (DD, p. 4.) The first day of the first test year, however, does not necessarily coincide with the expected effective date of rates. For example, currently utilities that file their GRC in January use the next calendar year as their test year. Their new rates are expected to be effective on January 1st the following year, which corresponds to the first day of the test year. The July filers however also use the next calendar year as their test year but their rates are not expected to be effective until sometime mid-year of the following year, which could be six months after the first day of the test year.

The draft decision proposes to reinterpret the first day of the test year in section 455.2 to mean the expected effective date of new rates as provided in the RCP and sets the test year for the January filers as the next calendar year, and for the July filers as the next fiscal year. (DD. p. 6 and Appendix, p. 2.) The DD,

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[1] Section 455.2: (a) The commission shall issue its final decision on a general rate case application of a water corporation with greater than 10,000 service connections in a manner that ensures that the commission's decision becomes effective on the first day of the first test year in the general rate increase application.

(b) If the commission's decision is not effective in accordance with subdivision (a), the applicant may file a tariff implementing interim rates that may be increased by an amount equal to the rate of inflation as compared to existing rates. The interim rates shall be effective on the first day of the first test year in the general rate case application. These interim rates shall be subject to refund and shall be adjusted upward or downward back to the interim rate effective date, consistent with the final rates adopted by the commission. The commission may authorize a lesser increase in interim rates if the commission finds the rates to be in the public interest. If the presiding officer in the case determines that the commission's decision cannot become effective on the first day of the first test year due to actions by the water corporation, the presiding officer or commission may require a different effective date for the interim rates or final rates.

(c) The commission shall establish a schedule to require every water corporation subject to the rate case plan for water corporations to file an application pursuant to the plan every three years. The plan shall include a provision to allow the filing requirement to be waived upon mutual agreement of the commission and the water corporation.

(d) The requirements of subdivisions (a) and (b) may be waived at any time by mutual consent of the executive director of the commission and the water corporation.

however, notes that "standard ratemaking practice uses 'test year' to refer to the period over which the cost of service and proposed rates will be evaluated."(DD, p. 5) Thus, the DD's reinterpretation of the first day of the test year conflicts with standard ratemaking practice.

The workshop report attempts to resolve this dilemma by changing the test year to comport with the legislation rather than changing the definition of the term "test year" (Workshop Report, Appendix A). Appendix A recommends that the test year and the effective date of new rates for the January filers be March 1st of the following year and for July filers be September 1st of the following year.

ORA has serious concerns with use of a non-calendar test year as proposed in both the draft decision for the July filers and in the workshop report for all filers. The Commission has always used the calendar year test year to avoid the additional workload that would be required and to simplify the ratemaking process. Switching to a non-calendar test year will create a tremendous amount of additional work for staff.

There are approximately fifteen categories of expenses. To the extent that the test year estimate depends on developing a forecast by using an inflation adjusted simple five year average escalated for the test year, five years of prior data, in each expense category will have to be recalculated for a time period that overlaps and splits two calendar years, instead of a full calendar year.[2] Similar calculations using split calendar years would have to be made for routine capital additions and sales.

Because utilities' results of operation are developed on a calendar year basis, split-year restatements of results will be necessary under the non-calendar test year approach. It will be difficult to verify the accuracy of any split-year

[2] For the January filers, this would mean taking 10 months from the current calendar year and 2 months from the next calendar year. For the July filers, it would mean taking 4 months from the current calendar year and 8 months from the next calendar year.

restatement of results. Also, deriving appropriate adjustment factors for a non-calendar year test year may be equally formidable. The ORA Energy Cost of Service Branch (ECSB) currently provides inflation escalation factors for calendar years, updated monthly. It would be inaccurate to create a hybrid number by taking 10/12 of one year and combining that with 2/12 of the next year. Inflation is not constant from one month to the next month throughout the year. For example, it could be extremely low in January and February and then rise markedly in the summer. The direction of the change is also unpredictable and therefore the inflation for a subset of months could be either higher or lower than the annual average. Yet, if a non-standard test year is adopted in this new rate case plan, ORA sees no other choice but to split up the inflation factors this way. ORA does not have monthly data and has access to only limited quarterly data. Modifying the inflation factors in this way, at a minimum, doubles the chance or errors, and will make utility filings harder to check, and thus require extra staff time.

ORA opposes using a non-calendar test year. Instead, ORA recommends that the Commission immediately seek to modify Public Utilities Code § 455.2 (a) and (b) as follows to ensure that the Commission decision becomes effective one year after the general rate increase application is filed, instead of on the first day of the first test year.

> **455.2**. (a) The commission shall issue its final decision on a general rate case application of a water corporation with greater than 10,000 service connections in a manner that ensures that the commission's decision becomes effective *one year after* ~~on the first day of the first test year in~~ the general rate increase application *is filed*.
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> (b) If the commission's decision is not effective in accordance with subdivision (a), the applicant may file a tariff implementing interim rates that may be increased by an amount equal

> to the rate of inflation as compared to existing rates. The interim rates shall be effective ~~on the first day of the first test year in~~ *one year after* the general rate case application *is filed*. These interim rates shall be subject to refund and shall be adjusted upward or downward back to the interim rate effective date, consistent with the final rates adopted by the commission. The commission may authorize a lesser increase in interim rates if the commission finds the rates to be in the public interest. If the presiding officer in the case determines that the commission's decision cannot become effective *one year after the filing date of the general rate case application* ~~on the first day of the first test year~~ due to actions by the water corporation, the presiding officer or commission may require a different effective date for the interim rates or final rates.

If Section 455.2 is modified in this way, the Commission can keep the existing rate case plan schedule for the most part, but use a calendar year as the test year for all filers as is done today.[3] ORA's proposed modification to the legislation is consistent with the legislative intent of AB 2838, which was to have interim rates go into effect in one year's time if a GRC decision was not forthcoming. It would also be consistent with the effective date for new rates as proposed in both the draft decision and Appendix A of the workshop report.

ORA believes it is feasible and realistic to seek clean-up legislation on this matter. ORA also realizes it could easily be January 1, 2005 before the amended legislation would take effect. However, the Commission and parties would know by the end of September whether this legislation had passed. That would give the

[3] Some adjustment would need to be made to account for the months from the beginning of the test year up until the effective date of rates.

2005 January filers ample time to prepare their GRC application using a 2006 calendar year as the test year.

The only remaining issue would be how to approach the GRCs for the 2004 July filers. ORA recommends that the Commission use the either the draft decision or workshop proposal for the July filers this year. Once the new legislation is in place, both the January and July filers should use a calendar year test year.

II. ORA RECOMMENDS SOME CHANGES TO THE WORKSHOP REPORT'S PROPOSED CHANGES TO FORECASTING

ORA supports the workshop proposed changes to the test year and escalation year forecasts as specified on pages 6 and 7 of Appendix A. Many of these changes, if adopted, will result in a streamlining of ORA's workload.

ORA does, however, disagree with changes made to the method for computing operational and maintenance expenses as proposed in Appendix A. The workshop report recommends**:**

> All administrative, operational and maintenance expenses with the exception of off-settable expenses and salaries should be computed by using recorded inflation and growth. An adjusted simple five year average escalated for test and subsequent years shall be included in the utilities workpapers.

The Draft Decision approach computing these expenses is:

> All operational and maintenance expenses with the exception of off-settable expenses and management salaries should be computed by using an inflation adjusted simple five year average escalated for test and subsequent years.

To make the DD consistent with the consensus recommendations on escalating expenses, ORA instead recommends the following:

> All administrative, operational and maintenance expenses, with the exception of off-settable expenses and salaries, should be computed by using an inflation

> adjusted simple five year average escalated for the test year. The amounts for the subsequent escalation years should be computed by adjusting the test year expenses by the applicable factor or union contract as described in the Expenses section of Appendix A.

ORA disagrees with using growth, in addition to recorded inflation, in computing the administrative, operational and maintenance expenses. Using growth in addition to recorded inflation would require an agreed upon number for growth; an estimate which is likely to be controversial. It would be inappropriate to use the growth in customers here, because work requirements and expense do not increase in proportion to customer growth. Other than meter readings, the plant associated with new customers is new and requires little maintenance. Productivity improvements should partially, if not fully, offset increases in workload as well. Factoring in growth in the estimation of escalation year expenses is unnecessary and will only complicate matters.

Finally, ORA makes one clarification to the "Expenses" section of Appendix A of the workshop report as follows:

> Non-labor escalation year expenses, excluding water production related expenses, will be estimated by escalating test year non-labor expenses by the most recent composite <u>compensation per hour for contract labor</u>/non-labor inflation factors published by ORA.[4]

ORA notes that the composite factor is a hybrid of the compensation per hour index which is applicable to contracted services and the non-labor factor.

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[4] ORA publishes "Estimates of Non-labor and Wage Escalation Rates" with inflation factors for in-house labor (wages) and non-labor. ORA also publishes a "Summary of Compensation per Hour" with inflation factors for outside, contract labor. The composite factor is a hybrid of 60% non-labor from the "Estimates of Non-labor and Wage Escalation Rates" and 40% compensation-per-hour from the "Summary of Compensation per Hour" memo.

III. ORA SUPPORTS THE DD'S HANDLING OF GENERAL OFFICE OPERATIONS

ORA supports the draft decision approach to escalating General Office ("GO") operations, which is to prorate comparable general office items by the applicable escalation rate.

ORA opposes the workshop proposal for handling GO (Workshop Report, Appendix D). The workshop proposal limits multiple district utilities to filing a showing for GO revenue requirement once every three-years. Under this proposal, the utilities would allocate the adopted GO revenue requirement to all of the utility's ratemaking districts at the time the Commission adopts the general office allocations. For those operating districts that have come in for their GRC, the allocated GO revenue requirement would be considered as one element of that district's total revenue requirement in the GRC proceeding. For those districts coming in for their escalation year step increases, the new GO allocation would be used in estimating the escalation year GO revenue requirement.[5] The proposal also includes the application of the historical earnings test intended to protect against potential over earning.

Some parties have suggested that the workshop proposal would result in labor savings by limiting the review of GO to once every three years.[6] ORA does not find this argument convincing enough to override the underlying principle to the Commission's established practice. The existing practice is to consider GO expenditures in the context of a GRC where each district's revenue requirement is reviewed in its entirety, and rates are set accordingly. For the GRCs filed in the intervening years, the Commission uses the previously adopted GO revenue

[5] ORA's understanding from the workshops is that, rather than having each affected utility file an advice letter implementing the change in general office revenue for all its non-GRC districts as stated in Appendix D, the new allocations would be considered at the time the district comes in for its escalation year step increase.

[6] While the utilities are not limited to filing for a GO review once every three years now, in practice, this is often the case.

requirement adjusted for inflation; or the utility can opt to have another review of its GO operations and use a new GO allocation. ORA sees no reason to change this. ORA believes that new GO allocations should only be applied to the districts *when they come in for their GRCs* and not be applied during the escalation year or at any other time as recommended in the Workshop Report. It is important for the Commission to look at all district expenses as a whole and to do so in conjunction with the growth in sales before making any adjustments to rates. GO is an expense that is within the control of the utility and should not be considered in a piecemeal fashion. For example, when California Water Service Company (CWS) requested authority to increase rates in each of its operating districts to recover increases in its GO revenue requirement in Application 01-05-002, the Commission rejected that request. In doing so the Commission said:

> Traditionally, the GO revenue requirement is addressed in GRC proceedings for the operating districts. The GO revenue requirement is estimated for the total company, and allocated to the operating districts. In this way, all the elements of each district revenue requirement are examined, and rates are set accordingly.
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> . . . In this proceeding, CWS asks that we adjust rates for the operating districts, by looking only at the GO revenue requirement allocations, without looking at other costs that may have also increased or decreased. Were we to do so, in the absence of a review of its overall operating costs, we would be reducing the risk of the utility's earnings, and the resulting incentive for the utility to be efficient. (D.02-06-067, p.6.)

There is neither need nor precedent for increasing the revenue requirement for forecasted GO expenditures outside of the GRC. When a water utility district comes in for its GRC under the new plan, it will receive an authorized rate increase (or decrease) for the test year and provisions for rate increases in each of the escalation years. As the Commission stated in D.02-06-067, in reference to CWS:

> these increases are intended to compensate CWS for net increases in its revenue requirements over the covered years, including the GO. Therefore, the fact that CWS estimates that its GO revenue requirement will increase does not justify adjusting rates outside of district GRCs. (*Ibid*.)

For all of the above reasons, ORA recommends adopting the draft decision recommendation for handling GO operations which would apply new GO allocations to the districts only when they come in for their GRCs.

IV. ORA SUPPORTS THE DD'S TREATMENT OF PLANT ADDITIONS WITH SOME MODIFICATION

For the most part, ORA supports the DD approach to handling routine and major capital additions. The DD requires the utility to provide a three year capital budget in each GRC, to separate capital projects into routine and major projects, to forecast routine capital additions in the escalation years by using the simple average of the last five years of recorded actual capital investment adjusted to reflect only routine capital additions excluding major capital projects and other nonrecurring items, and to file an advice letter to demonstrate that a major capital project has been constructed as planned and approved, and is ready to be placed in service.[7]

ORA has several suggestions to increase the workability of this plan.

1. Contrary to the Workshop report's recommendation in Appendix B, ORA recommends that major capital additions be limited to wells, filtration plants, tanks and office buildings. Routine capital additions should be defined as everything else. This definition is clear and easy to

[7] ORA also supports the requirements in the draft decision and the workshop report regarding the utilities' showing for the test and escalation year major plant additions. The DD and workshop report require the utility to include in its GRC filings a needs analysis, cost comparison and evaluation, conceptual design, and overall budget. The workshop report further recommends that the utilities' filing include data on capacity, cost, design/description, alternatives and purpose of the project. See March 22, 2004 Workshop Report, Appendix B, #1 and #2.

understand, and will limit the number of the advice letters for major capital additions the Commission receives each year.

2. ORA recommends the Commission adopt an inflation adjusted simple five-year average instead of a simple five-year average to account for inflation when forecasting routine capital additions in the escalation years.

The above two suggestions necessarily go together. In order to use a definition of routine capital additions that is defined as everything but a few specific projects, it is important to use a forecasting method based on a historical average. For example, if the forecasting method were based on the test year only, the utility might have an incentive to include as many projects as possible in the test year showing for routine capital additions.[8]

ORA recommends that routine capital additions be defined as everything other than wells, filtration plants, tanks and office buildings for purposes of simplicity. To make all projects not qualifying as routine subject to advice letter treatment runs the risk of creating a cumbersome process that adds unnecessary workload for both Commission and utility staff. Under such a scenario, ORA staff would have to spend extra time reviewing the GRC application to determine whether the utility has demonstrated that a plant addition is actually routine. Appendix B to the March 22, 2004 workshop report would divide routine plant additions into "established", "non-established" and "new", requiring the utility to make a showing as to each. ORA opposes this.

ORA had tentatively agreed to the workshop proposal of forecasting routine capital additions in the escalation years by applying an inflation factor to the routine capital additions adopted in the test year. ORA agreed to scope out the

[8] Because the escalation method recommended in the workshop proposal builds off the test year, it uses a stricter definition of routine capital additions. The workshop proposal essentially defines what is a routine, and defines everything else as a major capital addition subject to the advice letter process in the escalation years.

feasibility of developing a new factor called a "water plant index " or WPI, and to put together a proposal for workshop participants' consideration in Phase 2 of this proceeding. Parties further tentatively agreed to recommend that, for the interim, the utilities apply the most recent monthly non-labor rate weighted at 60% and the compensation per hour index weighted at 40% as published by ORA, Energy Cost of Service Branch (ECSB) for escalating routine capital additions. However, after preliminary investigations into the cost of developing such a factor, ORA concluded that developing a WPI is not feasible. As discussed at the workshop, ORA also concluded that the restrictive definition of "routine capital additions" proposed by workshop participants could end up undermining the streamlining goal of this proceeding. Therefore, ORA recommends the Commission adopt a simple definition of routine capital additions, and forecast the escalation years using an inflation-adjusted five year simple average.

One of the reasons the workshop looked at an alternate approach to forecasting routine capital additions in the escalation years was that the utilities argued that a forecast based on a simple five year average of the last five years of recorded actual capital investment would understate their true need. This may be true if, as they claim, routine capital investment increases every year. However, ORA asserts, that when looking at recorded routine capital investment, what you see is not a gradually increasing trend but relatively constant amounts varying up and down.[9] Therefore, an inflation-adjusted five-year simple average should

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[9] See, for example, CWS Bakersfield District Application 03-10-021. The recorded nonspecific/routine plant numbers are: 1993 - $1,302,876, 1994 - $922,286, 1995 - $1,051,741, 1996 - $1,428,984, 1997 - $988,920, 1998 - $950,882, 1999 -$1,512,603, 2000 - $672,861, 2001 - $1,243,739, 2002 - $1,874,915. *(Workpapers under Tab 8A/B, page 21 of 21 under the title of Non - Specific Capital Budget by Category.)*

yield reasonable results. If further adjustment is needed, ORA would accept an inflation-adjusted three-year simple average.

By limiting major capital additions to the few select projects in each GRC, the process outlined in the draft decision, which requires the utility to file an advice letter demonstrating that the project has been constructed as approved, and is ready to be placed in service, appears feasible.

In the workshops, the parties looked at a number of different ways of handling major capital additions. ORA identified the concerns underlying these various proposals as:

1. *Streamlining/simplicity*. Would the proposal reduce staff workload? Is it more streamlined and less work than the current rate case plan?
2. *Utility accountability*. Would the proposal ensure that the proposed capital addition was actually built? Would it ensure that what was actually built was substantially the same as what was proposed?
3. *Utility flexibility*. Would the proposal give the utility management discretion needed to allocate funds for capital items to areas most needed as utility priorities change? Would it avoid micro management of the utilities?
4. *Fairness*. Would the proposal provide sufficient provision for utility capital needs in the escalation years?
5. *Historical versus forecast ratemaking*. Would the proposal allocate funds for major capital additions in the escalation years at the beginning of each year or instead after the project was built?
6. *Preventing gaming the system*. Would the proposal prevent the utilities from gaming the system by earning a return on

phantom plant, getting approval for one project but then gold plating other projects that would not have been approved, etc.

7. *Balance increase in utility regulatory costs with benefits to ratepayers.* Since regulatory costs are passed on to rate payers, would the proposal be cost-effective when comparing benefits to utilities costs to comply with the new rate case plan.

ORA's proposal has the advantage of being streamlined, insuring utility accountability, and giving the utility management flexibility on routine capital additions. ORA's proposal makes sufficient provision for utility needs while providing ratepayers assurance that proposed major capital additions in the escalation years are constructed as planned and ready to be placed in service before being included in rate base. ORA's proposal also balances regulatory costs with ratepayer benefits.

ORA notes that this is a three-year rate case cycle. If major capital additions are limited to a very few specific projects, advice letter treatment is both feasible and streamlined. Complicated approaches, that may yield better results from certain viewpoints, are just not warranted.

V. OTHER ESCALATION YEAR ADDITIONS

A. Unforeseen Water Quality Projects

ORA opposes item # 6 in Appendix B of the Workshop Report which states:

> Other Escalation Year Additions – This category includes unexpected, unplanned water quality projects to meet water quality standards where a previously unknown need arises during the period between general rate cases (e.g., a new groundwater contaminant is discovered). During construction the utility will file an advice letter seeking authorization to open a memorandum account for recording the total cost of the project. The revenue requirement associated with the project will be tracked in the memorandum account and will be allowed to continue to accrue until the

> Commission has evaluated the project and costs for prudency, and allowed the project in the revenue requirement. (Highlighting in the original.)

The Commission should not include the process for handling unplanned water quality projects in the new rate case plan. Standard practice requires the utility to file an application to open a memorandum account for unforeseen items, including water quality projects. Advice letters are ministerial and require little analysis or justification. In contrast, when a utility files an application for an unforeseen project, it must pass the Commission's four prong test to determine if a memorandum account is appropriate.

In Resolution W-4276, the Commission stated, memorandum accounts are appropriate when the following conditions exist:

> a. The expense is caused by an event of an exceptional nature that is not under the utility's control;
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> b. The expense cannot have been reasonably foreseen in the utility's last GRC and will occur before the utility's next scheduled rate case;
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> c. The expense is of a substantial nature in the amount of money involved; and
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> d. The ratepayers will benefit by the memorandum account treatment. (Resolution W-4276, 2001 Cal. PUC LEXIS 685, *5.)

If the project passes the four-prong test, the Commission will authorize a memorandum account. It is in the public interest for the Commission to continue to require that unforeseen projects be subject to this test and thus handled through the application process.

VI. ORA ALSO SUPPORTS A SIMPLIFIED APPROACH TO DETERMINING ESCALATION YEAR REVENUE REQUIREMENTS.

If the Commission decides that it does not want to proceed with the process presented in the DD with ORA's modifications, ORA recommends that the

Commission consider using an alternative approach which ORA fully supports as well. This alternative would substantially simplify the escalation year process for the new water rate case plan, which is one of the major goals of this proceeding. Under this plan, instead of doing an item-by-item escalation of expenses and plant additions, the Commission would escalate the base margin revenue requirement excluding the off-settable expenses by the CPI-U and then reduce that by the increase in the revenues due to the increase in the number of customers estimated using the methodology in Appendix A. This has the advantage of being incredibly straightforward and simple. This proposal makes an implicit provision for new capital expenditures in each of the escalation years by escalating the entire capital-related portion of the base margin revenue requirement. The utilities' exposure to risk is mitigated by the fact that they will be filing their next GRC application at the beginning of the second escalation year.

VII. ORA SUPPORTS THE DD REQUIREMENT FOR TRANSACTIONS WITH AFFILIATES AND UNREGULATED ACTIVITIES

ORA concurs with the DD's requirements with regard to transactions with corporate affiliates and unregulated transactions. The DD requires the utilities to identify and explain all transaction with corporate affiliates and to demonstrate that these transactions are reimbursed at fully allocated costs. (DD, Appendix, p. 8.) The DD requires that the utilities identify, document and account for all unregulated activities that use assets or employees included in revenue requirements. (*Ibid*.) ORA agrees with these requirements.

As identified in the Workshop Report, the utilities seek to modify both of these areas by adding the words "consistent with the Commission's Decision on Excess Capacity" to the DD's requirements. ORA opposes these additions. First, it is not clear what it is that the utilities seek to change by adding this language. If the utilities are trying to change the content of what needs to be included in their rate case filing or how these transactions are handled, they should recommend specific language changing the DD.

Instead, the utilities' proposed change to refer to D.00-07-018, the Excess Capacity Decision, creates ambiguity and inconsistency. For example, the DD requires that the utility be reimbursed for transactions with affiliates at fully allocated costs. The Excess Capacity Decision requires non-tariffed services to absorb only incremental costs. (D.00-07-018, Finding of Fact 18.) Moreover, it appears to ORA that the Excess Capacity decision does not apply to affiliate transactions, as a number of different decisions cover how services to affiliates and unregulated activities are handled.[10]

ORA opposes the changes put forth in the workshop report and supports the DD requirements for corporate affiliates and unregulated transactions.

VIII. THE RATE CASE PLAN SHOULD NOT SPECIFY WHAT ORA MUST INCLUDE IN ITS BRIEFS

The DD and Workshop Report require ORA to include in its brief a "comprehensive discussion of the issues." (DD Appendix, p. 13; Workshop Report, Appendix A, p. 14.) The DD and Workshop Report further require ORA to "address in detail each issue identified by the applicant as 'contentious' in the application." (*Ibid*.) ORA opposes these requirement. While ORA makes every effort to present a thorough and detailed brief on all of its issues in the case, the content and level of discussion contained in ORA's brief must be left to ORA's discretion.

ORA needs the flexibility to prioritize its workload and determine the resources it is going to devote to a proceeding during all phases of the case. Due to resource limitation or other considerations, ORA may choose to not address all of the issues parties may identify as "contentious." Moreover, some of those

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[10] *See* Re Southern California Water Company, 80 CPUC 2d 580; Application of California American Water Company, D.01-02-068, Appendix B.

contentious issues may involve issues of interest to other parties and not ORA. The Commission acknowledged in its 2003 Work Plan to the Governor and Legislature that the agency "does not have the resources to address every issue" and it must "set its priorities by evaluating the relative costs and benefits of acting or not acting." (Commission 2003 Work Plan, p. 2.) ORA similarly does not have the resources to address every issue in every case. ORA must be permitted to determine which of the issues are worth pursuing given the resources available. The DD requirement defining what ORA must include in its brief usurps ORA management's ability to prioritize issues and assign staff accordingly.

IX. THE ENTIRE RATE CASE PLAN SHOULD BE SUBJECT TO REVIEW AND CHANGE AFTER TWO YEARS

The DD adopts ORA's proposal to review the adopted forecasting methodologies after a two-year experimental period. (DD, p. 14) ORA recommends that the Commission expand this experimental period to include review of the new RCP in total. It is possible and even likely that other issues concerning the adopted plan will arise during the next two years.

X. ORA AGREES THAT THE ISSUES IDENTIFIED IN APPENDIX C OF THE WORKSHOP REPORT SHOULD BE DEFERRED TO PHASE II

ORA supports the agreement reached in the workshop to defer certain items to a second phase of this proceeding. Most of these items do not need to be decided before the rate case applications are filed in July 2004. With the exception of # 4, ORA supports the workshops recommendation to address the following issues in Phase II:

1) Cost of Capital (see ORA section specifically on this).
2) Model for Summary of Earnings and decision appendices.
3) Schedule for filing Interim Rates.

4) Finalize water plant index or interim factor for escalating routine plant.[11]
5) Revision of earnings test.
6) Review Master Data Request.
7) Test year rate base for advances, contributions, etc.
8) Depreciation Expense for test and escalation years.
9) Effective date for rate base and escalation year Advice Letters.
10) Implementation issues – extra attrition year.
11) Penalties and deficiency review process.
12) Demographic information required in Proposed Application

ORA supports the workshop proposal to defer the cost of equity issues to Phase II where the matter can be considered in more depth in workshops. For the interim, parties agreed that the current rate case plan procedures for processing cost of capital should continue in place until there has been a decision in Phase II, including allowing of the usual updates.

If, however, the Commission does not want to defer this issue to Phase II, ORA supports the Draft Decision on this issue with one modification. ORA recommends that the Commission require the utilities to present return on equity (ROE) calculations based on the results from the Discounted Cash Flow, Risk Premium, and Capital Asset Pricing (CAPM) models.

The CAPM forms the basis of modern finance with its assumption that return should be positively correlated with risk. The risk/return relationship also forms the basis of Commission decisions on ROE. In D.92-11-047 (FOF 90), the

[11] ORA has determined that it is not feasible for ORA to develop at Water Plant Index, and has therefore recommended an inflation adjusted simple five year average be used to forecast routine capital additions in the escalation years. If the Commission adopts ORA's proposal in this phase of the proceeding, it will be unnecessary to discuss this item further.

Commission officially recognized the CAPM by mandating that energy utilities present results for all three models (DCF, RP, and CAPM) in cost-of-capital cases.

ORA understands that that Commission's Water Division intends to schedule a short workshop on the afternoon of April 8, 2004 to discuss in more detail the issues to be considered in Phase II and to draft a procedural schedule. ORA, therefore, does not present a schedule for Phase II in these comments. ORA hopes that from this workshop can come a consensus document that would address:

1) the need for this issue to be addressed in Phase II,
2) how to handle practical problems, if any, that may be created by delaying this issue to Phase II
3) the parties' concerns on each issue and desired outcomes in Phase II (i.e. conflicts that need to be resolved.)
4) estimated amount of workshop time needed to resolve the issue, or to further clarify areas of disagreement

This April 8, 2004 workshop should also produce a recommended draft procedural schedule with workshop dates, times and topics, a date for submission of the workshop report on Phase II issues, and dates for comments and reply comments on Phase II issues.

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X. CONCLUSION

ORA recommends that the Commission adopt the draft decision as modified above and adopt the portions of the workshop report where a consensus was reached. ORA further recommend that the Commission take action to modify Public Utilities Code § 455.2 as discussed above.

Respectfully submitted,

/s/ HALLIE YACKNIN

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April 2, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing document **“COMMENTS OF THE OFFICE OF RATEPAYER ADVOCATES ON THE DRAFT DECISION AND WATER DIVISION WORKSHOP REPORT”** in **RULEMAKING 03-09-005**.

A copy was served as follows:

[X] **BY E-MAIL**: I sent a true copy via e-mail to all known parties of record who have provided e-mail addresses.

[X] **BY MAIL**: I sent a true copy via first-class mail to all known parties of record.

Executed in San Francisco, California, on the 2nd day of April , 2004.

/s/ JACQUELINE GOROCH

JACQUELINE GORZOCH